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No. 01-739

In the Supreme Court of the United States

MORGAN CAPITAL, L.L.C.,

Petitioner,

v.

MEDTOX SCIENTIFIC, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of the Supreme Court of the United States, Respondent Medtox Scientific, Inc. (Medtox) states that it is publicly traded on the American Stock Exchange, that it has no parent company, and that no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

PAGE

CORPORATE DISCLOSURE STATEMENT i

TABLE OF AUTHORITIES iv

INTRODUCTION AND SUMMARY OF ARGUMENT 1

REASONS FOR DENYING THE WRIT 2

I. The Third "Question Presented" in the Petition Was Not Pressed or Passed on Below 2

II. The Eighth Circuit's Decision Does Not Present a Conflict. The Existence of a Federal District Court Opinion Does Not Create a Cognizable Conflict in the Circuits 5

III. The Eighth Circuit's Decision Was Correct 6

A. Morgan Capital Was a Deemed Ten Percent Beneficial Owner of Medtox Common Stock Before May 1, 1996 7

B. Morgan Capital's Conversion of Its Medtox Preferred Stock Into Common Stock Constituted a "Purchase" of the Common Stock 11

C. Morgan Capital Mischaracterizes the Actual Language in the SEC Rules and Ignores Means Readily Available to Issuers and Investors to Avoid Section 16(b) Liability Problems 13

CONCLUSION 17

TABLE OF AUTHORITIES

Cases	PAGE(S)
Blau v. Lehman, 286 F.2d 786 (2d Cir. 1961), *aff'd*, 368 U.S. 403 (1962)	12, 13
Editek, Inc. v. Morgan Capital, L.L.C., 150 F.3d 830 (8th Cir. 1998), *rev'g*, 974 F. Supp. 1229 (D. Minn. 1997)	4, 7, 8, 9, 10
Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976)	17
Global Intellicom, Inc. v. Thomson Kernaghan & Co., 1999 U.S. Dist. LEXIS 11378, Fed. Sec. L. Rep. (CCH) ¶ 90,534 (S.D.N.Y. 1999)	16
Heli-Coil Corp. v. Webster, 352 F.2d 156 (3d Cir. 1965)	12
Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973)	16
Levy v. Clearwater Fund IV, Ltd., 2000 U.S. Dist. LEXIS 1305, Fed. Sec. L. Rep. (CCH) ¶ 90,938 (D. Del. 2000)	6, 13
Levy v. Oz Master Fund, Ltd., 2001 U.S. Dist. LEXIS 9251, Fed. Sec. L. Rep. (CCH) ¶ 91,503 (S.D.N.Y. 2001)	5

Levy v. Southbrook Int'l Investments, Ltd.,
263 F.3d 10 (2d Cir. 2001) 15

Medtox Scientific, Inc. v. Morgan Capital, L.L.C., 258 F.3d 763 (8th Cir. 2001), *aff'g*, 50 F. Supp. 2d 896 (D. Minn. 1999) .. *passim*

National Collegiate Athletic Ass'n v. Smith,
525 U.S. 459 (1999) 2

Park & Tilford, Inc. v. Schulte,
160 F.2d 984 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947) 13

Reliance Electric Co. v. Emerson Electric Co.,
404 U.S. 418 (1972) 17

Roberts v. Galen of Virginia, Inc.,
525 U.S. 249 (1999) 2

Schaffer v. CC Investments, LDC,
115 F. Supp. 2d 440 (S.D.N.Y. 2000) 15, 16

Youakim v. Miller,
425 U.S. 231 (1976) 2

Statutes

15 U.S.C. § 78c(a)(13) 11

15 U.S.C. § 78p(a), (b) ..... *passim*

Rules

17 C.F.R. § 240.13d-3 9

17 C.F.R. § 240.13d-3(a) 9

17 C.F.R. § 240.13d-3(d)(1)(i)(B) ..... *passim*

17 C.F.R. § 240.16a-1(a)(1) ..... *passim*

17 C.F.R. § 240.16a-1(c)(6) 3, 4

Other Authorities

Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 28,869, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,709, 1991 WL 292000 (Feb. 8, 1991) 4, 12

INTRODUCTION AND SUMMARY OF ARGUMENT

Medtox respectfully requests that this Court deny the Petition for a Writ of Certiorari filed by Petitioner Morgan Capital, L.L.C. (Morgan Capital), seeking review of the opinion and judgment of the United States Court of Appeals for the Eighth Circuit entered on August 3, 2001.

The last of the three questions presented in the Petition is not properly before this Court. Morgan Capital never once pointed out the factual predicate for that issue during the four and one-half years this case was litigated in the federal district court and on two appeals to the Eighth Circuit. Morgan Capital never once raised that legal issue before the lower courts, notwithstanding two rounds of dispositive motion practice and two appeals. Morgan Capital's last-ditch, midnight hour effort to assert that issue for the first time in its Petition to this Court does not properly present that issue for this Court's consideration.

The Eighth Circuit's opinion does not give rise to a cognizable conflict. Its holding does not conflict with the holdings of any prior decisions of this Court or those of other courts of appeals.

Finally, the Eighth Circuit's decision is correct. The United States Securities and Exchange Commission (SEC) has promulgated detailed rules, pursuant to sections 13 and 16 of the Securities Exchange Act of 1934 (Act), governing "beneficial ownership" for purposes of section 16(b)'s proscription of "insider" short-swing trading. Applying the plain language of these rules, the Eighth Circuit correctly held that Morgan Capital was a deemed ten percent beneficial owner of Medtox common

stock before May 1, 1996. That status arose from (1) Morgan Capital's ownership of Medtox preferred stock, (2) the conversion feature giving Morgan Capital the contractual right to convert its preferred stock into common stock, (3) the conversion price formula, and (4) the declining price of Medtox's common stock during the critical period. The Eighth Circuit also correctly held that Morgan Capital's May 1, 1996 conversion of its preferred stock into common stock (at a time when Morgan Capital was a deemed ten percent beneficial owner of Medtox common stock) constituted a purchase of the common stock for section 16(b) purposes.

REASONS FOR DENYING THE WRIT

I.

THE THIRD "QUESTION PRESENTED" IN THE PETITION WAS NOT PRESSED OR PASSED ON BELOW.

This Court's settled practice is not to grant the writ when the "question presented was not pressed or passed upon below" because this Court does not decide, in the first instance, issues not decided below. *National Collegiate Athletic Ass'n v. Smith*, 525 U.S. 459, 469 (1999); *Roberts v. Galen of Virginia, Inc.*, 525 U.S. 249, 253-254 (1999); *see also Youakim v. Miller*, 425 U.S. 231, 234 (1976) (*per curiam*) ("[o]rdinarily, this Court does not decide questions not raised or resolved in the lower court[s]").

In its Petition, Morgan Capital points out that the conversion feature in its Medtox preferred stock had, in addition to the floating-price component which was actually used in calculating the number of shares of common stock Morgan Capital received upon conversion

of its preferred stock, a fixed-price component (Pet. at 2, 3-4, 9 n.5 and 12). Morgan Capital chides the Eighth Circuit for "ignoring" this fixed-price component in determining that the Medtox preferred stock was not a "derivative" security (Pet. at 13, 15, 17 and 19). This "hybrid" nature of the conversion feature is the predicate for the third "question presented" in the Petition (Pet. at i).

Morgan Capital omits to inform this Court that, during the four and one-half years in which this case was litigated in the federal district court in Minnesota and the Eighth Circuit, Morgan Capital never once brought to any court's attention that the conversion feature in its Medtox preferred stock contained a fixed-price component (intended to fix the minimum number of shares Morgan Capital would be entitled to receive on conversion). Morgan Capital never once argued, in the two rounds of dispositive motion practice before the district court or on either of the two appeals to the Eighth Circuit, that that fixed-price component feature had any relevance to the substantive section 16(b) issues and Morgan Capital's liability for its proscribed short-swing trading.

Morgan Capital consistently maintained during the course of the litigation in the lower courts that its Medtox preferred stock was not a "derivative" security because the conversion privilege was based on a "floating" rather than a "fixed" exercise price.[1] *See, e.g.*, Docket

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[1] SEC Rule 16a-1(c)(6) instructs that convertible securities with a "floating exercise price"—*i.e.*, a "conversion privilege at a price that is not fixed"—are excluded from the definition of "derivative" securities for section 16 purposes. 17 C.F.R.

(continued...)

Nos. 10, 16, 35 and 37 (JA 6, 7, 8, 9); *see also* Morgan Capital's Appellee's Brief in *Editek, Inc. v. Morgan Capital, L.L.C.*, 150 F.3d 830 (8th Cir. 1998) (*Medtox I*), at p. 8 ("until the conversion right was exercised and the floating price became fixed, the convertible Preferred Stock was not a "derivative security" under Section 16 so as to implicate beneficial ownership status and the resultant potential for short-swing profits liability"); *see also id.* at p. 24; Morgan Capital's Appellant's Brief in *Medtox Scientific, Inc. v. Morgan Capital, L.L.C.*, 258 F.3d 763 (8th Cir. 2001) (*Medtox II*), at pp. i, 2, 5, 6, 12, 15, 22, 25, 28, 30, 32; Morgan Capital's Reply Brief in *Medtox II*, at 4, 7.

The Eighth Circuit's opinions also accurately note Morgan Capital's position in this regard:

(1) "Because, as Morgan Capital acknowledges, none of the securities involved in this transaction were derivatives, these provisions are inapposite" (*Medtox II*, 258 F.3d at 765 n. 4 (Pet., App. A, p. 4a));

(2) "[Morgan Capital] argues that it was not an insider until the preferred stock was converted into common stock because the conversion price was floating, rather than fixed" (*Medtox II*, 258 F.3d at 767 (Pet., App. A, p. 7a)); and

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[1] (...continued)
§ 240.16a-1(c)(6); *see also* "Ownership Reports and Trading by Officers, Directors and Principal Security Holders," Exchange Act Release No. 28,869, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,709, 1991 WL 292000, at *17, text accompanying nn.134-139 (Feb. 8, 1991) (1991 SEC Release); *Medtox I*, 150 F. 3d at 834 (Pet., App. C, p. 48a).

(3) "In other words, Morgan Capital, as a holder of floating-price convertible preferred stock, did not own derivative securities" (*Medtox I*, 150 F.3d at 834 (Pet., App. C, p. 48a)).

Consequently, neither the federal district court nor the Eighth Circuit was ever asked to pass on whether the Medtox preferred stock was a "derivative" security because of the presence of the fixed-price component in addition to the floating-price component of its conversion feature. Moreover, even assuming, *arguendo*, that the presence of the fixed-price component could render the Medtox preferred stock a derivative security, neither the district court nor the Eighth Circuit was ever asked to consider whether under all the facts and circumstances presented by this case, Morgan Capital was nevertheless still liable under section 16(b). Because this issue was never presented by Morgan Capital below and because it was never passed upon by any of the courts below, this issue is not properly considered by this Court on the Writ.

II.

THE EIGHTH CIRCUIT'S DECISION DOES NOT PRESENT A CONFLICT. THE EXISTENCE OF A FEDERAL DISTRICT COURT OPINION DOES NOT CREATE A COGNIZABLE CONFLICT IN THE CIRCUITS.

Morgan Capital relies upon a district court decision, *Levy v. Oz Master Fund, Ltd.*, 2001 U.S. Dist. LEXIS 9251, Fed. Sec. L. Rep. (CCH) ¶ 91,503 (S.D.N.Y. 2001), in an attempt to create a conflict with the Eighth Circuit's decision (Pet. at 18-19). In *Levy*, the Southern District held that, under the circumstances in that case,

the floating-price and fixed-price features of the convertible security at issue there rendered it a "derivative" security. *But see Levy v. Clearwater Fund IV, Ltd.*, 2000 U.S. Dist. LEXIS 1305, Fed. Sec. L. Rep. (CCH) ¶ 90,938 (D. Del. 2000) (holding that convertible securities with such hybrid conversion price features are not derivative securities). The existence of a district court opinion, which passed on facts and legal issues never presented to and not decided by the Eighth Circuit, does not give rise to a cognizable conflict with the Eighth Circuit's opinion in *Medtox II*, within the meaning of Rule 10 of the Rules of the Supreme Court of the United States. No cognizable conflict exists between the Eight Circuit's decision and the decisions of any other federal circuit court decisions warranting granting of the Writ.

III.

THE EIGHTH CIRCUIT'S DECISION WAS CORRECT.

Morgan Capital also contends the Eighth Circuit erred in holding that (1) Morgan Capital was a deemed ten percent beneficial owner of Medtox common stock by virtue of its ownership of Medtox convertible preferred stock, under the facts and circumstances here, prior to May 1, 1996 (Question 1), and (2) Morgan Capital's conversion of its Medtox preferred stock into common stock on May 1, 1996 constituted a "purchase," for section 16(b) liability purposes, of the common stock (Question 2) (Pet. at i). Morgan Capital simply rehashes well-worn arguments that both the district court and the Eighth Circuit correctly rejected. *See Medtox II*, 258 F.3d at 766 (Pet., App. A, p. 6a), *aff'g*, 50 F. Supp. 2d 896, 901-05 (D. Minn. 1999) (Pet., App. B, pp. 24a-33a). The Eighth Circuit's holding was correct on both issues.

A. Morgan Capital Was a Deemed Ten Percent Beneficial Owner of Medtox Common Stock Before May 1, 1996.

The Eighth Circuit's holding on the first question presented is based on a straightforward reading of the applicable SEC Rules and application of those rules to the undisputed facts. Fundamentally, the Eighth Circuit's two opinions in this case stand only for the unremarkable proposition that those rules "mean just what [they] say[ ]." *Medtox I*, 150 F.3d at 833 (Pet., App. C, p. 45a).

At issue in this case is whether Morgan Capital was a ten percent beneficial owner of Medtox common stock before May 1, 1996 by virtue of its ownership of Medtox preferred stock.[2] If so, then Morgan Capital was a covered "insider,"[3] for purposes of section 16(b)'s proscrip-

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[2] Morgan Capital's assertion that it purchased Medtox preferred stock "on or about February 1, 1996" is misleading (Pet. at 2). The record shows that Medtox and Morgan Capital entered into Private Securities Subscription Agreements (*e.g.*, JA 170-177), pursuant to which Morgan Capital purchased Medtox preferred stock on January 30, 1996 (JA 156, Table 1; JA 171 Art. 1(ii)). January 30, 1996 is the legally significant date: it is the date on which the first shares of Medtox preferred stock were issued, and the pertinent agreement provided that the preferred stock was convertible to common stock commencing on the sixtieth day after the first share was issued which, in this case, was March 30, 1996 (JA 183 § 4(c)). February 1, 1996 is the date on which the transaction "closed" and Morgan Capital actually received its shares of Medtox preferred stock (JA 175 Art. 4).

[3] Section 16(b) incorporates by reference section 16(a)'s scheme of three categories of an issuer's covered "insiders":

(continued...)

tion on short-swing trading for a profit by "insiders" in their issuer's securities, on May 1, 1996, which is the date on which Morgan Capital engaged in the first of the transactions that Medtox contends (and the Eighth Circuit held) gave rise to its section 16(b) liability. *Medtox II*, 258 F.3d at 766-67 (Pet., App. A, pp. 6a-7a). In its Schedule 13D filed in May 1996 after the conversion, Morgan Capital admitted that it owned 18.2% of Medtox's outstanding common stock as of May 9, 1996 (JA 273, ¶ 4; JA 283, Items 11, 13). By an Amended Schedule 13D filed in July 1996, Morgan Capital admitted that, even after selling off a portion of its Medtox common stock in May and June 1996, it still owned 15.44% of Medtox's outstanding common stock as of July 3, 1996 (JA 273 ¶ 5; JA 289).

SEC Rule 16a-1(a)(1) instructs that, in "determining whether a person is a beneficial owner of more than ten percent of any class of [registered] equity securities," the term "'beneficial owner' shall mean any person who is deemed a beneficial owner pursuant to section 13(d) of the Act." 17 C.F.R. § 240.16a-1(a)(1) (Pet., App. E, pp. 67a-68a); *see Medtox I*, 150 F.3d at 832 (Pet., App. C, p. 43a); *Medtox II*, 258 F.3d at 765 (Pet., App. A, p. 4a).

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[3] (...continued)
officers, directors, and ten percent beneficial owners. 15 U.S.C. § 78p(a), (b) (Pet., App. E, p. 65a). The first two "classes" of covered "insiders"—the issuer's officers and its directors—are not applicable here because Morgan Capital was not an officer or director of Medtox, and Morgan Capital's principals, David and Alexander Bistricer, did not become members of the Medtox board until after the challenged transactions giving rise to liability here had been completed. *Medtox II*, 258 F.3d at 765, 766 (Pet., App. A, pp. 2a, 6a).

SEC Rule 13d-3, promulgated under section 13(d) of the Act, provides rules governing the determination of beneficial ownership. 17 C.F.R. § 240.13d-3. Rule 13d-3(d)(1)(i)(B) expressly and unambiguously provides that:

> A person shall be deemed to be the beneficial owner of a security . . . if that person has the right to acquire beneficial ownership of such security, as defined in Rule 13d-3(a)[4] within sixty days, including but not limited to any right to acquire . . . [t]hrough the conversion of a security.

17 C.F.R. § 240.13d-3(d)(1)(i)(B) (Pet., App. E, p. 66a); *see Medtox I*, 150 F.3d at 832-33 (Pet., App. C, pp. 43a-44a); *Medtox II*, 258 F.3d at 765 (Pet., App. A, p. 4a). As the Eighth Circuit observed, the import of Rule 13d-3(d)(1)(i)(B) is that a person is deemed to own beneficially any securities the person has the right to acquire "within sixty days" through conversion of another security. *Medtox II*, 258 F.3d at 765 (Pet., App. A, p. 4a).

In the first appeal, the Eighth Circuit simply applied the plain meaning of SEC Rules 16a-1(a)(1) and 13d-3(d)(1)(i)(B) in holding that Morgan Capital was a ***deemed beneficial owner*** of Medtox ***common*** stock before May 1, 1996, by virtue of its ownership of Medtox ***preferred*** stock which provided Morgan Capital the contractual right to convert the preferred stock into common stock

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[4] Rule 13d-3(a) provides that a person beneficially owns a security when the person has either voting power or investment power with respect to the security, whether directly or indirectly. 17 C.F.R. § 240.13d-3(a); *see Medtox I*, 150 F.3d at 832 (Pet., App. C, p. 43a).

beginning on March 30, 1996.[5] *Medtox I*, 150 F.3d at 832-834 (Pet., App. C, pp. 41a-48a); *see also Medtox II*, 258 F.3d at 766, 767 (Pet., App. A, pp. 5a, 7a-8a). Indeed, Medtox had publicly reported, on March 27, 1996, that Morgan Capital was the largest beneficial owner of Medtox common stock (JA 137-38 ¶ 2 & n.1; JA 140-41).

In the second appeal, the Eighth Circuit held that the district court had correctly determined that Morgan Capital was a deemed ***ten percent*** beneficial owner of Medtox common stock from April 9 through April 30, 1996. *Medtox II*, 258 F.3d at 765, 767-68 (Pet., App. A, pp. 3a, 7a-10a). The court reasoned that Morgan Capital had the right to convert its preferred stock into common stock on each of those days and that, had it done so, given the prevailing market price of Medtox common stock during that period and the applicable conversion formula, the number of shares of Medtox common stock Morgan Capital would have received on every day during this period would have constituted more than ten percent of the outstanding common stock. *Id.* The Eighth Circuit correctly observed that the five-day trailing average, look-back feature of the conversion right meant that Morgan Capital could readily ascertain each day the number of shares of common stock it would receive if it elected to convert. *Medtox II*, 258 F.3d at 767 (Pet., App. A, pp. 7a-8a).

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[5] In *Medtox I*, the Eighth Circuit held that application of SEC Rules 16a-1(a)(1) and 13d-3(d)(1)(i)(B) meant that Morgan Capital was "a beneficial owner of [Medtox] common stock on every day within sixty days of every day on which Morgan Capital had the right to acquire [Medtox] common stock through conversion." 150 F. 3d at 833 (Pet., App. C, p. 46a).

Morgan Capital also argues, at least implicitly, that holding it liable under section 16(b) is somehow inequitable here, contending that:

> This [the fact that the shares of common stock Morgan Capital received upon its May 1, 1996 conversion of its preferred stock amounted to more than ten percent of Medtox's outstanding shares of common stock] was unintended even by Medtox; Medtox ran out of a sufficient number of common stock to meet the demands of all preferred holders exercising conversion rights.

(Pet. at 4) Morgan Capital does not cite to any evidence in the record to support this assertion. *Id.* Morgan Capital does not do so for the simple reason that the record contains no evidentiary support for this assertion.

B. Morgan Capital's Conversion of Its Medtox Preferred Stock Into Common Stock Constituted a "Purchase" of the Common Stock.

The Eighth Circuit's holding on the second question presented (*Medtox II*, 258 F.3d at 768-69 (Pet., App. A, pp. 11a-12a)), is based on a straightforward reading of the Act, the 1991 SEC Release, and decades of section 16(b) jurisprudence teaching that conversion of preferred stock into common, when the preferred stock is not a "derivative security," constitutes a "purchase" of the common for section 16(b) liability purposes.

First, the Act defines the term "purchase" broadly: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." 15 U.S.C. § 78c(a)(13). Conversion transactions fit into the "otherwise acquire" language.

Second, the 1991 Release also teaches that conversion of floating exercise price convertible preferred stock constitutes a purchase of the underlying common stock:

> The rules adopted today clarify that a right with a floating exercise price is not required to be reported and will not be deemed to be acquired or purchased, for Section 16 purposes, until the purchase price of the underlying securities becomes fixed or established, which commonly occurs at exercise. Thus, ***a right to purchase an equity security is deemed acquired as of the date the exercise or conversion price becomes fixed, and the acquisition, absent an exemption, would be matchable for Section 16(b) purposes with a disposition within six months of the fixing of the price.*** For example, the acquisition of an option having an exercise price equal to 90 percent of the market price as of the date of exercise would be deemed to be a purchase of the underlying stock as of the date of exercise.

1991 SEC Release, 1991 WL 292000, at *18, text accompanying nn. 146-147 (emphasis added).

Finally, courts have consistently held that conversion of one security into another constitutes a "purchase" for section 16(b) liability purposes. *See, e.g., Heli-Coil Corp. v. Webster*, 352 F.2d 156, 159, 161, 167, 169 (3d Cir. 1965) (conversion of convertible debentures into issuer's common stock and subsequent sale of common stock within six months held violative of section 16(b), court reasoning that conversion involves "purchase" of acquired security as well as "sale" of surrendered security); *Blau v. Lehman*, 286 F.2d 786, 792 (2d Cir. 1961) (holding exchange of common stock for preferred stock was "purchase" of preferred within scope of section 16(b), reasoning transaction is "purchase" for section 16(b) purposes

if it lends itself in any way to accomplishment of that which statute was designed to prevent), *aff'd*, 368 U.S. 403 (1962); *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984, 987 (2d Cir.) (conversion of preferred stock into common stock followed by sale within six months held to constitute "purchase and sale" violative of section 16(b)), *cert. denied*, 332 U.S. 761 (1947); *Levy v. Clearwater Fund IV, Ltd.*, 2000 U.S. Dist. LEXIS 1305, at *13, Fed. Sec. L. Rep. (CCH) ¶ 90,938 (D. Del. 2000) (holding conversion of stock having both fixed and floating conversion price components constituted purchase of underlying stock, subjecting holder to section 16(b) liability for subsequent sales within six months for profit).

Consistent with the Act, the SEC's interpretive Rules, the 1991 SEC Release, and precedent, the Eighth Circuit correctly held that Morgan Capital's May 1, 1996 conversion constituted a "purchase" of common stock, subject to section 16(b)'s proscription on any sales of that common stock within six months.

C. Morgan Capital Mischaracterizes the Actual Language in the SEC Rules and Ignores Means Readily Available to Issuers and Investors to Avoid Section 16(b) Liability Problems.

Morgan Capital attacks the Eighth Circuit's holding that it was a deemed ten percent beneficial owner of Medtox common stock before May 1, 1996, arguing that Morgan Capital had no "ascertainable and legally enforceable right to acquire" more than ten percent of Medtox's outstanding common stock before May 1, 1996 (Pet. at 8-9, 13-14). While it is true that Morgan Capital did not have a contractual right to acquire ten percent or more of Medtox's common stock before May 1, 1996, that fact is legally irrelevant. It is irrelevant because Morgan

Capital's argument proceeds from a premise that requires the engrafting onto Rule 13d-3(d)(1)(i)(B) of the language "ten percent" after the language "right to acquire." Rule 13d-3(d)(1)(i)(B) does not measure "beneficial ownership" in terms of a specified percentage of a class of equity securities. It simply provides that "[a] person shall be deemed to be the beneficial owner of a security . . . if that person has the right to acquire beneficial ownership of such security . . . within sixty days, including . . . any right to acquire through the conversion of a security." 17 C.F.R. § 240.13d-3(d)(1)(i)(B).

The Eighth Circuit did not hold that Morgan Capital had any contractual "right," before May 1, 1996, to acquire more than ten percent of Medtox's common stock upon the conversion of its preferred stock. Rather, it held only that:

(1) Morgan Capital beneficially owned Medtox common stock before May 1, 1996 because it had the right to acquire Medtox common stock (without regard to the actual percentage that might be acquired) within sixty days by converting its preferred stock, satisfying the test set forth in Rule 13d-3(d)(1)(i)(B); and

(2) Because of the declining price of Medtox common stock in April 1996, *if* Morgan Capital ***had chosen*** to convert its preferred stock into common stock on any of the days between April 9 and 30, the number of shares it would have received on conversion would have amounted to more than ten percent of the outstanding shares of Medtox common stock.

Medtox II, 258 F.3d at 767-68 (Pet., App. A, pp. 6a-10a). The former is all the Rule requires. The latter, as the Eighth Circuit reasoned, is mere math, dictated by sec-

tion 16's requirement, but not Rule 13d-3(d)(1)(i)(B)'s, that the beneficial ownership reach the threshold of ten percent. *Medtox II*, 258 F.3d at 768 (Pet., App. A, pp. 9a-10a).

Morgan Capital also seeks to construct a "straw man" in its Petition, arguing that the Eighth Circuit's holding creates "a new class of imaginary beneficial ownership," and treats what it characterizes as "hypothetical conversions" as "actual conversions" (Pet. at 8). However, the Eighth Circuit did nothing more than give effect to the plain meaning of SEC Rules 16a-1(a)(1) and 13d-3(d)(1)(i)(B), applying them to the pertinent provisions in the contractual agreement between Morgan Capital and Medtox governing Morgan Capital's preferred stock.

Finally, Morgan Capital postulates that the Eighth Circuit's holding will generate "chaos" and "mass confusion" in the securities marketplace with respect to section 16(a) reporting obligations and section 16(b) liability concerns because holders of floating price convertible securities might, over time, float above, and then below, ten percent beneficial ownership (Pet. at 8-10). This is an unwarranted concern. Morgan Capital conveniently ignores the prophylactic measures that are available to avoid the imaginary "chaos."

Conversion caps have been upheld as a legitimate means of structuring transactions to avoid short-swing liability under section 16(b). *Levy v. Southbrook Int'l Investments, Ltd.*, 263 F.3d 10, 12, 16 (2d Cir. 2001); *Schaffer v. CC Investments, LDC*, 115 F. Supp. 2d 440, 442-43 (S.D.N.Y. 2000) (same; citing cases). A conversion cap limits a convertible security holder's contractual conversion rights to the extent a conversion would otherwise result in the holder crossing over a specified percentage threshold of beneficial ownership. For example, a share-

holder rights agreement could include a provision such as:

> The Preferred Stock shall not be convertible by a Holder to the extent (but only to the extent) that, if converted by such Holder, the Holder would beneficially own in excess of 4.9% (9.9% if the applicable box on the signature page of the Securities Purchase Agreement for such Holder is marked) . . . of the shares of Common Stock.

See Schaffer, 115 F. Supp. 2d at 442 (quoted example upheld as valid). By operation of Rule 13d-3(d)(1), holders of freely convertible securities are "generally deemed to be beneficial owners of the underlying common stock." *Global Intellicom, Inc. v. Thomson Kernaghan & Co.*, 1999 U.S. Dist. LEXIS 11378, at *46-*47, Fed. Sec. L. Rep. (CCH) ¶ 90,534 (S.D.N.Y. 1999). However, when conversion rights are limited, a holder of a convertible security may not be deemed the beneficial owner of the underlying common stock. *Id.* A conversion cap limits the holder's rights to acquire a certain number of shares of the common stock; a holder who is prevented, by operation of the cap, from acquiring beneficial ownership of common stock in excess of a specified threshold within sixty days cannot become a deemed ten percent beneficial owner under Rule 13d-3(d)(1). *Levy*, 263 F.3d at 12-16; *Schaffer*, 115 F. Supp. 2d at 442-43. To the extent holders of convertible securities desire to avoid getting squashed by section 16(b)'s "crude rule of thumb" (*Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 592 n.23 (1973)), they can bargain for that protection by including such clauses in their contractual agreements with issuers. Of course, holders can also avoid any section 16(b) liability problems altogether simply by holding the shares of the common stock obtained upon conversion

for a period of six months and one day because section 16(b) only proscribes "short-swing" trading for a profit, which section 16(b) defines as a sale and purchase or purchase and sale within less than six months. *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 252 (1976); *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 422 (1972).

CONCLUSION

The Petition for a Writ of Certiorari should be denied for all these reasons.

Respectfully submitted,

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